

VZCZCXRO3684
RR RUEHDE
DE RUEHAS #0708/01 1430845
ZNY CCCCC ZZH
R 230845Z MAY 07
FM AMEMBASSY ALGIERS
TO RUEHC/SECSTATE WASHDC 3669
INFO RUEHHH/OPEC COLLECTIVE
RUEHLO/AMEMBASSY LONDON 1621
RUEHMD/AMEMBASSY MADRID 8569
RUEHMO/AMEMBASSY MOSCOW 0163
RUEHFR/AMEMBASSY PARIS 2196
RUEHRB/AMEMBASSY RABAT 1772
RUEHTU/AMEMBASSY TUNIS 6612
RUEHCL/AMCONSUL CASABLANCA 2973
RHEBAAA/DEPT OF ENERGY WASHDC
RUCPDO/DEPT OF COMMERCE WASHDC

C O N F I D E N T I A L SECTION 01 OF 04 ALGIERS 000708

SIPDIS

SIPDIS

E.O. 12958: DECL: 05/19/2032
TAGS: [ENRG](#) [EPET](#) [ECON](#) [EINV](#) [AG](#)
SUBJECT: ENERGY MINISTER UNMOVED BY CRITICISM OF CHANGES TO
HYDROCARBON LAW

REF: A. 06 ALGIERS 01769
[1](#)B. ALGIERS 00628
[1](#)C. WILLIAMSON - FORD EMAIL MAY 7

Classified By: Ambassador Robert S. Ford; reasons 1.4 (b), (d).

THIS CABLE CONTAINS COMPANY PROPRIETARY INFORMATION NOT TO BE
SHARED OUTSIDE USG.

[1](#)1. (C) Summary: Minister of Energy and Mines Chakib Khelil told Ambassador May 19 that the new hydrocarbon amendments were intended to slow oil development to maintain natural resources for future generations while redressing "unfair gains" made by foreign partners on certain contracts. He signaled that Algeria intended to hold the next international licensing round by the end of 2007 but that it might demand undetermined conditions on such bids, possibly to include technological requirements or guaranteed downstream market access. The Ambassador cautioned that U.S. companies were finding the business climate more difficult. If the Algerian goal was to attract more investment and technology transfer the government is going in the wrong direction, he warned. The Ambassador said the way to start improving the business climate was for a simpler and more regular dialog between the government and the U.S. firms. Khelil detailed the disputes Algeria was currently having with U.S. firms Anadarko and Conoco-Philips at one point musing that relations could hardly get any worse than they are now. The minister seemed to acknowledge that bureaucratic hurdles facing foreign investors in Algeria did not contribute to a healthy investment climate but he was loath to recognize that Algeria's policies might be detrimental to Algeria's long-term hydrocarbon development. End Summary.

LEAVE RESOURCES IN THE GROUND AND DON'T OVERPAY

[1](#)2. (C) Khelil explained a dual rationale for the new hydrocarbon amendments. Highlighting the country's weak administration, the minister cited the risk of wasting Algeria's natural resources as the primary motivation for amending the hydrocarbon laws. With little capacity for Algeria to invest its hydrocarbon largesse in Algeria or abroad, Khelil said that a political decision had been made to slow down the pace of the country's energy development in order to leave natural resources in the ground for future generations. The minister noted that this decision was intended to postpone the development of small fields in particular, since the new requirement that Sonatrach take a

51 percent share of new projects would make them undesirable for foreign bidders. The required Sonatrach investment would be a boon for foreign investors on bigger projects, Khelil explained, because it equally required Sonatrach to pony up 51 percent of all major projects' investment.

13. (C) The second key change in the legislation, the minister said, was to impose a windfall profits tax on existing oil contracts that were not previously subject to profit-limitation clauses (ref A). (Note: In practice, this change only impacts Anadarko Petroleum and its partners, ENI and Maersk, under their existing production sharing contracts for oil. BHP Billiton, the only other original contract from the 1980s that would have been hit by the windfall profits tax, recently renegotiated its contract with Sonatrach. The windfall profits tax will not apply to new contracts, which are likely to have profit-limiting clauses embedded, nor to existing gas contracts, such as those with British Petroleum. End Note.) The minister explained that the affected contracts had been signed at a time when oil was USD 15 per barrel. Given the fact that these companies had already recouped their investments, and in the context of socialist politicians, such as opposition leader Louisa Hanoune, leaning in the direction of outright nationalization, Khelil said that Algeria sought to redress the "unfair gains to foreign partners." He noted that the formula had been determined so that the foreign partners received roughly the same return on investment as when they signed their contracts. He conceded that "maybe it was our fault" that Algeria did not insert profit limitation clauses in the original contracts, but the current price of oil now required Algeria redress this oversight. He claimed other countries, such as the UK, had recently amended their policies regarding

ALGIERS 00000708 002 OF 004

depreciated investments.

POSSIBLE CONDITIONS ON NEW BIDS

14. (C) Khelil said that the most recent Council of Ministers meeting, chaired by President Bouteflika, had approved the long-awaited implementing regulations for the hydrocarbon amendments. By formalizing the relationship between Sonatrach and the new regulatory agencies ALNAFT and ARH, Algeria would be ready to move ahead with the next international licensing round, hopefully by the end of 2007. The bidding process would occur differently than before in that conditions might be set for winning bidders, although he added that these had not yet been determined and were still under discussion. The first condition, Khelil explained, might be that winning bidders bring certain types of technology or technical know-how to Algeria. Khelil did not specify the second possible condition, but launched into a discussion of Algeria's current troubles entering the Spanish market (septel), suggesting that downstream market access might be a precondition for future upstream developers. (Note: Khelil also alluded at this time to Russia, which had recently rejected Sonatrach's bid to build an LNG project in the Baltic Sea. He said he had told Energy Secretary Bodman during his recent visit to the U.S. that GAZPROM could face a similar situation in Algeria. Moreover, this follows Khelil's public expression of interest during the visit for Sonatrach to develop downstream projects in the U.S. End Note.)

NOT ALL U.S. COMPANIES ALIKE

15. (C) The Ambassador told Khelil that if Algeria's intention was to continue to attract U.S. investment and technology transfer, it was incumbent upon Algeria to establish a positive business climate. The Ambassador said that he did not want to go into the specifics of individual commercial disputes, which were more appropriately handled through business rather than official channels. That said, the

Ambassador stressed that the overall sense in the American business community was that Algeria's recent actions had been unhelpful to attracting new and sustained investment. The minister interjected that he would very much like to discuss the individual cases to show the Algerian perspective.

¶6. (SBU) Khelil claimed that Anadarko had violated its "gentleman's agreement not to go to litigation" and from that point he had personally "lost faith" in them. The Ambassador clarified that, according to Anadarko, the company had entered into conciliation, which was a precursor to arbitration or litigation. The Minister blurted that "they sued us" and said he considered Anadarko's conciliation to be the same as litigation. (Note: Anadarko representatives in Algiers confirmed to us May 22 that it was Sonatrach, not Anadarko, that had initiated the conciliation process, not the other way around. This process concluded in February without a resolution and thus remains at a stand-still. End Note.) Khelil noted that he was further irritated with Anadarko for "leading the pack" and "blocking its partners from investing in Algeria unless Anadarko gets a piece," thus limiting some otherwise interested companies from entering the Algerian market. Khelil was personally insulted that Anadarko apparently had gone around him to raise the taxation issue with the Algerian Finance Ministry. (Note: Anadarko representatives in Algiers told us May 22 that at no time had the company approached the Ministry of Finance regarding the new taxes. End Note.) The Ambassador cautioned that unilateral Algerian actions had caused major financial losses to the American company which had had a signed contract. The Ministry's reluctance to clarify what it was doing and where it was going had significantly hurt the company financial situation. More than ever, he noted, serious dialogue was needed between the government and the company. Khelil indicated he had no intention of putting anything new in front of Anadarko, but he later said he would receive the company president if he came to Algeria.

¶7. (SBU) On Conoco-Philips, Khelil claimed that an operational error resulting from "human mismanagement at Burlington Resources" had caused production to stop and

ALGIERS 00000708 003 OF 004

Algeria to lose revenue. He said this was not a standard catastrophic loss, but the result of "error in management." By demanding Conoco-Philips to pay for this loss as a condition of its transfer of ownership from Burlington, Khelil said that Algeria was merely demanding conformity with Algerian law. He further asserted that Algeria had a right to demand a fee which corresponded to a percentage of the assessed value. In contrast to the problems with Conoco-Philips and Anadarko, the minister cited Hess as a company with which the Algerians had a "wonderful" relationship. He added that he had seen company chairman John Hess during his recent visit to the U.S. and that Hess signaled an interest in increasing the company's position in Algeria. (Comment: the Hess assets in Algeria are considerably smaller than those of either Anadarko or Conoco-Philips. End Comment.)

ACCESS PROBLEMS

¶8. (C) Ambassador pointed to the Conoco-Philips example and highlighted to Khelil that numerous energy companies, American and other, had complained about the difficulty of getting meetings in Algeria with officials in Sonatrach or the Ministry of Energy who were empowered to make decisions. If power was concentrated in the office of the minister, Ambassador continued, it should come as no surprise that companies were going to request meetings with the minister. (Note: Khelil reportedly had convoked the heads of the major energy companies operating in Algeria to his office last fall to tell them that he was not interested in meeting with their visiting senior management unless they had an explicit reason to see him. End Note.) Khelil responded that the companies'

counterparts were either Sonatrach (for existing production sharing contracts) or the new regulatory agency ALNAFT (for contracts signed in the future). But as with any state-operated entity, the minister added obliquely, both were ultimately subject to politically driven decisionmaking.

COMMENT: DEALING WITH MINISTER KHELIL

¶9. (C) While Khelil was once the advocate of broader openness of the Algerian market to foreign participation, he has now accepted the political reality of the changes and is enforcing them outright, even if it goes against what are probably his better instincts. The minister's view that foreign oil companies such as Anadarko, now having recouped their initial investments, are just sitting back and watching their bank accounts grow does not take into account such firms' plans for future investment. (Anadarko, for one, is unlikely to proceed with its estimated USD 4 billion investment in the Merck fields or further develop its other existing blocks under the status quo.) The minister appeared to swallow that Algeria's actions had hurt the business climate and he did not seem to care. Having established gas development as its strategic priority, the Algerian leadership apparently believes it can ignore -- and even punish -- petroleum producers with impunity. Numerous foreign petroleum companies have told us that Khelil has a take it or leave it attitude in negotiations. With the implementing regulations signed and the taxation formulas drawn up, Khelil appeared to dismiss any concerns expressed by foreign oil companies as simple non-compliance with Algerian law and regulations.

¶10. (C) As the discussion of the Anadarko case demonstrated, Khelil voiced more the fiercely nationalistic logic that currently appears to be driving Algerian economic policy than the pragmatism of a technocrat with two decades of experience at the World Bank. The minister's reluctance to meet with energy officials below his rank reflects could be interpreted as the leadership style of a manager seeking to empower lower-level decisionmakers (in this case the Sonatrach or ALNAFT officials responsible for overseeing individual contracts). We have seen little delegation of authority, however. Instead, Khelil's stance appears to reflect the Algerian attachment to protocol above all else. The minister's quip about Anadarko going behind his back to talk to the Finance Ministry, which Anadarko denies, also rang a petulant tone. For now, the logic of Khelil the politician

ALGIERS 00000708 004 OF 004

has overpowered that of Khelil the energy-sector technocrat.

¶11. (C) Our sense is that the meeting between Secretary Bodman and Minister Khelil in Washington on May 7 (ref C) for the first time put U.S. concerns to Khelil directly. The day after that meeting in Washington the Algerian government after four months wait set up the Ambassador's meeting; they suddenly decided they needed to engage us, and we delivered the message about a deteriorating business environment rather bluntly. With world oil prices high, the Algerians may well not be interested in attracting much new investment into their oil sector. As we think about how to help our own firms, and improve the broader business climate, we need to find opportunities to accent that Algeria will not secure the technology transfer it seeks if it adopts such aggressive tactics against foreign companies. We should not exaggerate the problems - some U.S. energy firms, such as Hess, having dodged a bullet with the recent changes to the hydrocarbon amendments, are operating quietly and, for the most part, contentedly. Neither should we leave the Algerians with the mistaken impression that doing business here is just as easy as in other major energy exporting countries. Given Khelil's concentration of power in his hands, if he stays in the Energy Ministry it is to him personally that we have to drive home our message.

FORD